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The natural market fallacy: Slim pickings in Latin America

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Abstract:

*A central issue in this era of globalization is whether any regional **trade** grouping - in Asia, **Europe**, or the Americas - represents the best course for the world economies and whether the US in particular has any natural markets. President Clinton's proposal for a Western Hemisphere free **trade** area, announced at the Miami summit in December 1994, is grounded in the conviction that the US has such a market in Latin America. But even if Latin American states were to accept the labor and environmental controls Congress wants to include in new **trade** agreements, they are far less attractive trading partners for the US than Mexico and Canada. Moreover, the drive toward economic regionalism would move the global economy in the wrong direction. US exports to Latin America, particularly to the economies of South America, are limited. These limitations stem from a continuing history of aggressive protectionism and an insistence that foreign firms produce their goods in-country.*

Full Text:

A central issue in this era of globalization is whether any regional trade grouping-in Asia, Europe, or the Americas-represents the best course for the world economy, and whether the United States in particular has any natural markets. President Clinton's proposal for a Western Hemisphere free trade area, announced at the Miami summit in December 1994, is grounded in the conviction that the United States has such a market in Latin America. His vision, in essence the creation of a much-expanded North American Free Trade Agreement (NAFTA) by the year 2005, sounds grand. But even if Latin American states were to accept the labor and environmental controls Congress wants to include in new trade agreements, they are far less attractive trading partners for the United States than Mexico and Canada. Moreover, the drive toward economic regionalism would move the global economy in the wrong direction.

U.S. exports to Latin America, particularly to the economies of South America, are limited. The Commerce Department is fond of including the region's largest economy, Brazil, among the world's big emerging markets. However, what Brazil and other emerging markets truly have in common is that they have all been slowgrowing as customers for U.S. exports. These limitations stem from a continuing history of aggressive protectionism and an insistence that foreign firms produce their goods in-country. The automobile industry provides a good illustration. In Brazil, the tariff on imported cars of 63 percent is cut in half for locally made cars that have significant local content.

The overall result of such policies is that U.S. merchandise exports to Brazil were $12.7 billion in i996-sizable, but little more than the 2 billion the United States exported to thinly populated Australia. For additional perspective, consider that in 1996 the United States exported $26 billion to Korea, $i8 billion to Taiwan, and 16 billion to Singapore, three Asian tigers with far smaller populations than Brazil. America's exports per capita to comparable markets are similarly revealing. In 1996 America's per capita exports were $604 to Mexico, $430 to Malaysia, $291 to Chile, $132 to Argentina, $120 to Thailand-and just $80 to Brazil's vaunted big emerging market.

These statistics illustrate an often forgotten fact about U.S. exports to South America: aside from the 14.5 million Chileans, most people in South America have not been particularly good customers for U.S. products. Americans tend to think otherwise because of the way U.S. exports are reported: South America is commonly combined with Central America and Mexico to form the single category of Latin America. But lumping Mexico together with Central and South America conceals more than it reveals, and in particular hides two basic facts about Mexico. The first is the large size of the Mexican market for U.S. products. The second is that as a result of history and geography, America's products and investment have dominated Mexico's economy since Grover Cleveland was president.

EUROPE'S BAILIWICK

America's century-long dominance in Mexico was obviously not the result of NAFTA. After all, it was in 1985, a decade before NAFTA was negotiated, that Mexico became America's third-largest market, and it was in 1990 that Mexico first bought more from the United States than did all the rest of South and Central America combined. That gap now exceeds $15 billion and continues to widen. Mexico's imports of $56 billion from the United States in 1996 maintained its position as America's third-largest market, after Canada and Japan. Mexico's per capita imports from the United States are also large. Little or none of that commerce is NAFTA'S creation, although the treaty is expanding both nations' exports.

America's economic relationship with South America is fundamentally different. In the South American economies, unlike Mexico's, the nations of Western Europe have long had a major role. In Brazil and Argentina, the region's major players, Europe has been dominant. In Brazil's market, close competition between the United States and Western Europe gave way to clear dominance by European suppliers by 1993 and a lead of $2.5 billion in imports by 1996 ($15.5 billion versus $13 billion). In Argentina, Western Europe has consistently led the United States, and the gap ($7 billion versus $5 billion) has become pronounced in recent years. Because the Argentine market is so much smaller than Brazil's, the $2 billion lead is even more significant.

The pattern in exports is also clear. Brazil's exports to the countries of the European Union have been well above those to the United States since at least 1988. The difference was almost $5 billion in 1996.

Argentina's exports to the EU have consistently been twice the level of those to the United States for more than ao years. In 1996 Argentina's exports to the Netherlands and Germany alone equaled those to the United States.

Investment patterns tell the same story. While many believe U.S. investment dominates South America, the reality is different. According to studies by the United Nations and the Organization for Economic Cooperation and Development, Western Europe has been South America's heaviest investor, especially in its larger economies. In Argentina, for example, where total foreign investment through 1989 was $6.5 billion, more than half was from Western Europe. In Brazil, America's secondary role is even more stark: of a total of $35 billion invested through 1990, the U.S. share was $10.5 billion-less than the total investment stock of just Germany, Great Britain, and Switzerland. In total, Western Europe accounted for nearly twice the U.S. share. The same pattern applies to South America as a whole.

UNNATURAL MARKETS

These trade and investment figures show that aside from Mexico, Latin America is not a natural market for the United States. President Clinton, like President Bush before him, sees an enlarged NAFTA as the model for a Free Trade Area of the Americas (FTAA), but it is a model that does not fit. NAFTA grew from America's long-standing dominance of both Canadian and Mexican trade and investment, and the benefits of trade with Mexico and Canada are the result of America's historical relationship with those two countries, not NAFTA. That bond has been absent in South America, and an FTAA will not create it.

In 1980, more than 6o percent of Canada's exports were already directed to the United States; by 1995, that had risen to 8o percent. Likewise, two-thirds of Mexico's exports went to the United States in 1980, and by 1995, that share had risen to 83 percent. More than two-thirds of Canada's imports consistently have come from the United States, and the U.S. share of Mexico's imports rose from 61 percent in 1980 to 75 percent in 1995.

There is no parallel U.S. role in South America. For the past quarter-century South American imports from the United States have not reached even 3o percent of total imports, and since the early 198os they have averaged just 26 percent. Even in Chile, where both exports and imports have become quite geographically diversified, imports from the United States have averaged just 21 percent.

RISKS OF RIVALRY

Any advantages from extending NAFTA to the rest of the hemisphere will be outweighed by several disadvantages. First, by pressing for an FTAA, President Clinton will be promoting the spread of regionalism, which, under the conditions that have shaped international trade through most of the postwar era, is a misfit from an earlier age. Especially in the form best known as regional free trade areas-but which Jagdish Bhagwati and other economists have rightly called preferential trade areas-economic regionalism's main flaw is its central nature: it is based on geographic proximity

Proximity was a key factor in foreign trade before World War II, when knowledge of foreign markets for one's products and the cost of transporting them made neighbors and near-neighbors each other's most likely best customers. But today distance has become essentially irrelevant. In an era when containerized shipping has drastically lowered the costs associated with bulk freight, the most distant markets for moving great quantities of high-value products have been opened up by express air freight, and electronic communication has made price and product data instantly available, the difference between Kuala Lumpur and Rio de Janeiro has become not a question of distance but of which market has the customers with the most money.

Moreover, regional trading blocs will undermine America's leading role in world trade, which developed from the current global trading regime. Even now, leaders in Brazil, who have long regarded the United States as their rival for hemispheric leadership, have seized on the difference between Clinton's FTA and their own southern Latin American trade grouping, MERCOSUR, as a reason for an imagined contest. MERCOSUR is an old-fashioned customs union, with a single tariff against all outsiders. Brazil's commitment to rivalry with the United States was underscored in late 1996 when it quashed a study by the World Bank's chief trade economist, Alexander Yeats, that criticized MERCOSUR. He showed that MERCOSUR's promotion of Brazilian-Argentine trade came at the expense of both countries' economic efficiency and welfare because MERCOSUR had diverted trade from lowercost producers. At Brazil's insistence, the study's publication was delayed and stripped of most criticisms of MERCOSUR.

The purported contest with Brazil is one the United States should not enter. An FTAA has no political urgency for the United States and, just as important, no economic merit for either America or the world economy. Clinton's vision is a retrograde threat to both: it would undermine America's unrivaled stake in the multilateral global economy, which it has built almost single-handedly since World War II, symbolized by the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). It is the multilateral and global trading systems from which the United States has most benefited, and to which it should remain strongly committed.

One measure of how well the American economy has performed since World War II is that the United States is once again the world's leading exporter, with a historically unprecedented portion of its economy now connected to markets everywhere in the world. To risk undermining the global trade regime because of an imagined natural market in South and Central America, and to risk making Japan and others in Asia look defensively to their own region, is not in the U.S. national interest.

AMERICASCLEROSIS?

Despite the success of the GATT-WTO format, the growth of regional sentiment, stemming from the undoubted success of Europe's trade model in the 196os and 1970s, has accelerated. Americans need to recognize that Europe's initially successful efforts at regional economic integration have begun to reach their limits. In Germany in particular there is heightened awareness that while the level of intraEuropean trade-often exceeding twothirds of the countries' total international commerce-has brought many benefits, it has more recently been accompanied by industrial stagnation and a growing inability to compete in world markets.

One indication of that awareness is that the Federation of German Industry, the country's largest industry association, has sponsored a study of a possible new EU-U.S. trade relationship that would lead to a Transatlantic Free Trade Area. Its 1996 report argued that Europe's economic regionalism has reached its limits: "Recognizing the high costs which protection inflicts on the economy, German trade policy should strive to promote global free trade. If it is possible to apply [the] Transatlantic Free Trade Area (TAFTA) for this purpose, most German firms will win." These second thoughts about European economic regionalism, the prospect that an FTA would undermine the global trading regime by promoting regionalism in Asia and elsewhere, and the evidence that there is no natural market for the United States in the Western Hemisphere should be a wake-up call for Americans when they are asked again to support President Clinton's call for a Free Trade Area of the Americas.

[Author note]

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